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KSA passes long-awaited mortgage law

By Moustafa Said

Early in July 2012 the Council of Ministers in the Kingdom of Saudi Arabia passed the eagerly anticipated mortgage law, the first of its type in the country. The objectives of the law are to regulate the Kingdom's real estate financing and investment, boost its mortgage market and set regulations for establishing mortgage companies and their activities.

A mortgage law has been mooted for over 30 years, but has faced delays as authorities have attempted to address concerns to ensure that real estate financing can be given in a Shari'ah compliant manner. On the one hand, banks have long-awaited a regulatory regime encompassing the registration of securities and provisions associated with the lenders' enforcement and execution rights. On the other hand, the ability of a bank to evict a defaulting borrower and exercise its right of power of sale is often regarded as being inconsistent with Shari'ah law principles.

To date, the absence of a mortgage law has meant that the availability of real estate financing, particularly for low and middle-income segments, has been quite limited. Saudi nationals have often had to rely on parental support and other methods to purchase a home. Accordingly, the value of mortgages is estimated to be no more than approximately 2 percent of the country's GDP, a figure which is substantially lower than in other countries (including in the region) with more developed mortgage markets.

Many analysts expect that the mortgage law will act as a catalyst for the domestic real estate sector, widen the pool of potential homeowners and spur developers to address the growing shortage of housing supply in the Kingdom.

Although it is generally acknowledged that there is a housing supply shortage in the Kingdom, and that this shortage is increasing each year, developers have often noted that demand for housing units is not as strong as the housing shortage would suggest. Whilst there are other factors that underpin this, such as the rising cost of land and land-banking, an important additional factor is the lack of cost-effective long-term financing options for prospective homeowners.

By including provisions enabling banks and other companies to finance real estate projects, and giving effect to a foreclosure regime, the law is intended to minimise the risk of lenders providing credit for real estate transactions, thereby expanding the availability of Shari'ah compliant financing to Saudi nationals.

The mortgage law comprises one limb of a package of five laws dealing with the registration of mortgages, the regulation of finance companies, real estate funding, financial leasing and enforcement and execution of mortgages, and it is expected that further regulations will be implemented in due course.

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Whilst the release of the mortgage law may or may not have an immediate impact, over time the greater legal certainty associated with mortgage financing is likely to lead to lower borrowing costs, to the benefit of lenders and borrowers, and the real estate financing industry, alike.

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